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INFO RUEHAS/AMEMBASSY ALGIERS PRIORITY 7612
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RUEHLO/AMEMBASSY LONDON PRIORITY 1419
RUEHNK/AMEMBASSY NOUAKCHOTT PRIORITY 0957
RUEHFR/AMEMBASSY PARIS PRIORITY 1892
RUEHRB/AMEMBASSY RABAT PRIORITY 8495
RUEHTRO/AMEMBASSY TRIPOLI PRIORITY 0190
RUEHCL/AMCONSUL CASABLANCA PRIORITY 4185
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S E C R E T SECTION 01 OF 03 TUNIS 000113

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STATE FOR NEA/MAG (HARRIS)
STATE PASS USTR (BURKHEAD)
USDOC FOR ITA/MAC/ONE (NATHAN MASON) AND CLDP (TEJTEL AND
MCMANUS)
CASABLANCA FOR FCS (ORTIZ)
CAIRO FOR FINANCIAL ATTACHE (SEVERENS)
LONDON AND PARIS FOR NEA WATCHER

E.O. 12958: DECL: 02/06/2018
TAGS: EFIN EINV KCOR TS
SUBJECT: SHOW ME THE MONEY: TUNISIA'S CAPITAL MARKETS
REMAIN A LIABILITY

REF: A. 07 TUNIS 1433

¶B. 06 TUNIS 2848

Classified By: Ambassador Robert F. Godec for Reasons 1.4 (b) and (d).

SUMMARY

¶1. (C) Tunisian business people, current and former bankers, and even GOT officials complain that continued weakness, mismanagement and corruption in the banking sector plague Tunisia's whole financial system. The problems in the banking sector not only restrict available credit, but distort access to credit, benefitting the well-connected to the detriment of new entrepreneurs. With domestic investment rates low and stagnant (Ref A), financial sector problems discourage entrepreneurship, hinder further investment and slow growth. The persistence of relationship-based banking has allowed Tunisia's largest companies to ignore the stock market, relegating the market to relative obscurity. Financial sector reform is critical to achieving the real GDP growth necessary to address Tunisia's serious unemployment problem; more important, however, is restoring domestic investor confidence in the economy and the GOT itself. End Summary.

Bad Loans, Bad Banks

¶2. (C) Despite repeated IMF admonitions and subsequent claims by the GOT that they are addressing the problem, Tunisia's banks remain weak -- already burdened by a high percentage of non-performing loans coupled with continuing bad lending practices (Ref B). While recent banking sector restructuring and privatizations have led to improved management and asset portfolios at several banks, non-performing loans (NPLs) continue to represent a significant, and unacceptable, ratio of overall banking sector assets. The high rates of NPLs

create a drag on bank operations by restricting the availability of credit to the market. Although the Central Bank reports that the rate of NPLs has dropped to about 20 percent from a high of 25 percent several years ago, many bankers estimate that several banks, particularly state-owned banks, continue to hold NPL portfolios of nearly 40 percent.

¶3. (S) According to one former bank chairman, lending practices have not improved because the biggest corporate offenders are protected by regime insiders -- or at least claim to be. He told EconOff that Neji Mhiri, Chairman of the Meubletex Group, one of Tunisia's largest, holds nearly 540 million dinars (roughly US $450 million) in debt. He noted that this means on interest alone he should be paying 50 million dinars a year to two different banks. Instead of being asked to make payments, however, Mhiri has been rewarded with membership on the Central Bank's Board of Directors. The banker recounted that Mhiri is known to intimidate people by referencing his frequent contact and close relationship to President Ben Ali. (Note: Mhiri is rumored to be a distant cousin of Ben Ali.) Given the financial pressure these debts create, bankers are constantly looking for signs that governmental support is waning for their financially troubled clients. The banker highlighted the case of Abdessalem Affes, Chairman of the Affes Group, whose debts were finally called in last year when the banks received the signal that they could collect. The debts had existed for over ten years and Affes had been allowed to accumulate new loans in the meantime. The banker highlighted that "there is a significant and literal cost to delaying reform": during that time period, Affes' debt grew from 40 million dinars (US $33 million) to 180 dinars (US $150 million).

"Transparency has a Cost"

¶4. (C) Tunisian business people, current and former bankers, and even GOT officials complain that continued weakness and mismanagement in the banking sector plague Tunisia's whole financial system. Although Tunisia's benchmark stock index, Tunindex, reported 20 percent growth in 2007 and 44 percent growth in 2006, the number of companies listed remains insignificant at only 50. Almost all of Tunisia's largest companies remain unlisted and there are few indications that any of them plan to list in the near future. In a meeting with EconOff, Zeinab Gellouz, the President of the Financial Market Council (CMF - Conseil des Marches Financiers), Tunisia's equivalent of the Securities and Exchange Commission, stressed the rigorous oversight provided by the CMF and the detailed financial statements required for public listing. (Note: Shortly afterwards, Gellouz was replaced as President. One banking contact lamented her departure as she was known for her frankness and her desire to push reform. End Note.)

¶5. (C) When asked for an evaluation of the low number of listed companies, Gellouz stated that "transparency has a cost." Gellouz added that Tunisian firms are accustomed to working in a relationship-based banking system, where they know their banker and are not required to provide detailed financials to raise capital. Alaya Bettaieb, president of a venture capital fund, complained that Tunisian bankers evaluate the person, not the project. Gellouz remarked that this system allows Tunisia's large companies to go straight to the banks without the added burden of transparent financial records, providing little incentive for public listing.

Getting Credit

¶6. (C) While the largest Tunisian firms continue to benefit from weak banking practices, access to credit continues to present a difficulty for entrepreneurs and small businesses. Saidane emphasized that relationship-based banking allows easy access to credit for big companies and the well-connected and that the big firms monopolize available credit -- in spite of GOT initiatives to facilitate credit for small and medium business creation. A recent CNN financial article featured a letter from a Tunisian complaining that "you can't get a bank loan unless you already own a business." Many successful entrepreneurs tell EconOff that the most important relationship is with one's banker. They say that knowing a banker is more important to receiving a loan than having a well-developed project. One businessman told EconOff he switched banks to follow his favorite banker and noted that doing so was not uncommon.

¶7. (C) Despite a proliferation of venture capital firms, financial professionals acknowledge that the effort has thus far failed to spur the creation of start-ups. Gellouz characterized Tunisian venture capital as "pseudo credit," noting that many venture capital funds continue to require collateral. Due to GOT fiscal incentives created to encourage the creation of venture capital funds, many commercial banks created their own funds. Gellouz lamented that this merely led to an extension of existing bank credit procedures, rather than an evaluation of project viability. "These are bankers," she stated, "they are evaluating the guarantee rather than the risk."

Building the Market

¶8. (C) In December, the Financial Market Council created a small cap fund modeled after the British Alternative Investment Market in an effort to list more Tunisian companies. Zeinab Gellouz stated that over 90 percent Tunisian companies are small and medium businesses. She told EconOff that 20 companies are ready to list on the alternative market. Looking forward, Gellouz stated that the GOT targets 20 percent capitalization in 2009. She highlighted that the market had already grown from 3.5 percent capitalization in 2004 to 10.5 percent in 2007. Gellouz emphasized that the real benefit to increasing listings is improved transparency and that the stock market is the "gauge of total transparency." Yet, banking contacts are pessimistic about the future growth of the stock market, noting the absence of any major companies. Notably, even majority state-owned Tunisie Telecom is not listed on the market, perhaps indicating GOT ambivalence towards the market. Saidane emphasized that current stock market growth is just "speculation," rather than representing real increases in value (Ref A). Citibank Director General Haykel Belhassine was similarly pessimistic about the stock market's potential, arguing that the presence of major companies is necessary for investor confidence.

Comment

¶9. (S) Tunisia's weak financial market continues to be a drag on faster economic growth. Although banking sector reform is critical, many of the failures in Tunisia's financial sector reflect broader concerns with economic governance. Corruption is not limited to the banking sector and the persistent rumors of high-level corruption do not bode well for reform. And while well-functioning capital markets are crucial to an efficient economy, banking reform alone will not address the lack of investor confidence. Despite an official GDP growth rate of 6.3 percent in 2007, Tunisian investors tell us they are not bullish about economic growth prospects -- and that they do not trust the numbers.

Restoring domestic investor confidence in the economy, and in the GOT itself, is essential to achieving the real GDP growth the country needs to address its serious unemployment problem. Healthy levels of FDI have allowed the GOT to delay serious action and restructuring, but postponing reform grows more and more costly. End Comment.
GODEC